Bath & North East Somerset Council	
MEETING:	**AVON PENSION FUND INVESTMENT PANEL**
MEETING DATE:	**27 May 2022**
TITLE:	**Review of Investment Performance for Periods Ending 31 March 2022**
WARD:	ALL
AN OPEN PUBLIC ITEM	
List of attachments to this report: Appendix 1 - Mercer Performance Monitoring Report Appendix 2 – Brunel Quarterly Performance Report Exempt Appendix 3 – Quarterly Portfolio Monitoring Summary Appendix 4 – Brunel Presentation: Multi Asset Credit Portfolio	

1. THE ISSUE

1.1. This paper reports on the performance of the Brunel and legacy portfolios and seeks to update the Panel on routine aspects of the Fund's investments. The report contains performance statistics for periods ending 31 March 2022.

1.2. The Mercer Performance Monitoring Report at Appendix 1 is presented in its revised format and will continue to evolve over time to focus on strategic issues.

1.3. Appendix 2 is the quarterly performance report published by Brunel which focuses on the performance of the Brunel portfolios and responsible investment activity undertaken on the Fund's behalf over the quarter.

1.4. The performance of the Fund's Risk Management Framework is considered separately under Agenda Item 10 – Risk Management Framework Review.

1.5. Exempt Appendix 3 contains a summary table which is designed to flag any concerns from a performance, operational and/or RI perspective. The table has been compiled using data provided by Brunel as part of their routine reporting process.

1.6. Appendix 4 is a Brunel presentation which focuses on the Multi Asset Credit Portfolio. Brunel will present the paper at the meeting.

2. RECOMMENDATION

2.1. **Notes information as set out in the reports.**

2.2. **Identifies any issues to be notified to the Committee.**

3. FINANCIAL IMPLICATIONS

3.1. The returns achieved by the Fund for the three years commencing 1 April 2019 will impact the next triennial valuation which will be calculated as at 31 March 2022. The returns quoted are net of investment management fees.

4. INVESTMENTS UPDATE

A – Fund Performance

4.1. The Fund's assets decreased by £69m in the quarter (-1.1% net investment return) ending March 2022 giving a value for the Fund of £5,826m.

4.2. The first quarter of 2022 proved challenging for markets with Russia's invasion of Ukraine causing a global shock that threatened growth-outlooks as economic ramifications began to materialise. As Russia and Ukraine are both large producers of energy, metal and food, this conflict, and the accompanying sanctions, exacerbated inflation while adding further upward pressure on commodity prices. Another emerging threat to global growth came from the latest Covid outbreaks in China and the supply disruptions expected from strict lockdowns in major cities such as Shanghai. While commodities were up over the quarter, most other assets such as fixed income, equity and listed property funds were down. The MSCI All Country World Index was down 2.4% in GBP terms with energy being the best-performing sector. In the UK, inflation rose to 6.2% in February, its highest rate in 30 years, with the Bank of England (BoE) forecasting inflation to peak in the spring at around 8%. The BoE raised rates to 0.75% over the quarter. Elsewhere, the US Federal Reserve raised interest rate by 0.25%, for the first time since 2018, as it attempts to control 40-year inflation highs brought about by geopolitical tensions and pandemic-related supply shocks. Similarly high inflation rates hit the Eurozone and, while not raising rates, the European Central Bank increased the pace of reductions within its asset purchase program. In UK LDI markets, gilt yields rose by 67bps across the curve. Across Private Markets, Infrastructure funds globally raised $70bn, a 42% higher rate than their previous peak. This was led by renewables as the war in Ukraine increased the desire for energy security alongside traditional environmental drivers. In particular, energy transition funds designed to decarbonise the economy continued to expand. Private Debt managers have gained from muted activity in the public markets by offering opportune financing solutions to upper-middle and large-cap borrowers. Finally, UK property deal volume rebounded over the quarter, with Hotels, Residential ad Student Accommodation attracting interest. Sterling depreciated against the US Dollar by 2.8%, by 0.6% against the Euro and appreciated by 2.5% against the Japanese Yen. Further information on Q1 asset class performance can be found in the Mercer report at Appendix 1.

B – Investment Manager Performance

4.3. The Mercer report at Appendix 1 provides strategic level information including total fund level performance, current funding level and an analysis of how the Fund's mandates are performing against expected strategic returns.

4.4. Brunel reports on the performance of the assets they manage on behalf of the Fund. The report for each Brunel portfolio can be found on pages 18-32 of Appendix 2.

4.5. Overall, the Fund saw a negative return over the quarter. Leading detractors Global High Alpha and Global Sustainable Equities produced absolute returns of

-8.0% (-5.8% on a relative basis) and -9.8% (-7.5% on a relative basis) due to the significant bias to lower-carbon companies and Growth/Quality tilts. The Passive Paris Aligned Passive Portfolio also saw negative absolutes returns of -3.7%, in line with its benchmark, with Utilities and Financials being two of the only positive contributors to returns over the quarter. In credit markets, Multi Asset Credit (MAC) posted a -2.7% return vs. the 1.1% cash benchmark, having been negatively affected by rising inflation and increased corporate and sovereign credit spreads due to the invasion of Ukraine. Although behind its benchmark for the quarter, the Diversifying Returns Fund manged to produce a positive 0.4% return with big positive contributors including commodity moves and long currency positions in the Brazilian Real and Norwegian Kroner. Core Infrastructure, Renewable Infrastructure, Secured Income and Property portfolios all produced positive absolute returns despite the uncertainties brought on by supply chain issues and inflation. Of those mandates with a 1-year track record the majority still earnt positive absolute returns over the year, with notable outperformance across the Brunel UK Property and IFM Infrastructure portfolios. The currency hedge detracted 0.4% over the quarter as Sterling weakened.

5. INVESTMENT STRATEGY AND PORTFOLIO REBALANCING

5.1. **Returns versus Strategic Assumptions:** Returns since the last valuation date (March 2019) for all equity mandates (with the exception of the passive Paris-aligned fund where track record is insufficient to draw conclusions) and core and renewable infrastructure are ahead of the assumed strategic returns used during the 2019/20 investment review. International property is below expectations as the mandate has been impacted by the pandemic. Due to the way this portfolio invests (capital drawn down over time) the focus should be on longer-term performance. Brunel Diversifying Return Funds is also marginally behind expectations due to a dampening of performance over the past three quarters. Other mandates are either still in build-up phase or do not have a sufficient track record to properly compare against strategic return assumptions.

5.2. **Rebalancing:** In line with recommendations from our equity review, the quarter saw the remaining balance of our Brunel Low Carbon Passive portfolio (£221m) switched into the Paris Aligned Benchmark (PAB) Fund.

The wind-down of the JPM hedge fund mandate continues with the second redemption of $80m settling in February and a third scheduled for May.

5.3. **Responsible Investment (RI) Activity**: A summary of RI activity undertaken by Brunel is included on page 11 of Appendix 2.

As part of the ongoing ESG communications strategy the fund published a member-focused climate change action plan on the website. This incorporated the key pillars of disclosures required under TCFD while also setting out our and associated climate commitments, as required under our IIGCC Net Zero Asset Owners pledge. Post quarter end the second edition of the Fund's e-zine was published on the website and distributed internally. This publication included a summary of the RI member survey and a case study on the renewable credentials of Biomass, which the Fund has exposure to through its renewable infrastructure allocation.

5.4. **Voting and Engagement Activity:** Hermes engaged with 209 companies held by Avon in the Brunel active portfolios on a range of 719 ESG issues. Environmental topics featured in 23% of engagements, 86% of which related

directly to climate change. Social topics featured in 21% of engagements, where conduct and culture, human rights and diversity featured prominently. Of the 40% of Governance related engagements most focussed on executive remuneration and board diversity. Over the last quarter Hermes made voting recommendations at 119 meetings (1,042 resolutions). At 42 meetings they recommended opposing one or more resolutions. 79% of the issues Hermes voted against management on comprised board structure and remuneration. During the quarter, the underlying investment managers undertook the following voting activity on behalf of the Fund:

Companies meetings voted: 403
Resolutions voted: 5,348
Votes For: 4,580
Votes Against: 645
Abstained: 62
Withheld vote*: 61

***** *A Withheld vote is essentially the same as a vote to abstain, it reflects a view to vote neither for nor against a resolution. Although the use of 'abstain' or 'withheld' reflects the different terms used in different jurisdictions, a 'withheld' vote can often be interpreted as a more explicit vote against management. Both votes may be counted as votes against management, where a minimum threshold of support is required*

6. RISK MANAGEMENT

6.1. The Avon Pension Fund Committee is the formal decision-making body for the Fund. As such it has responsibility to ensure adequate risk management processes are in place. It discharges this responsibility by ensuring the Fund has an appropriate investment strategy and investment management structure in place that is regularly monitored. The Investment Panel further strengthens the governance of investment matters and contributes to reduced risk in these areas.

7. EQUALITIES

7.1. A proportionate equalities impact assessment has been carried out using corporate guidelines and no significant issues have been identified.

8. CLIMATE CHANGE

8.1. The Fund is implementing a digital strategy across all its operations and communications with stakeholders to reduce its internal carbon footprint in line with the Council's Climate Strategy. The Fund acknowledges the financial risk to its assets from climate change and is addressing this through its strategic asset allocation to Paris Aligned Global Equities, Sustainable Equities and renewable energy opportunities. The strategy is monitored and reviewed by the Committee.

9. OTHER OPTIONS CONSIDERED

9.1. None

10. CONSULTATION

10.1. The Council's Section 151 Officer has had the opportunity to input to this report and have cleared it for publication.

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Background papers	Data supplied by Mercer, Brunel & State Street Performance Measurement
Please contact the report author if you need to access this report in an alternative format	